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TAGS: ECON EFIN ETRD EINV AR
SUBJECT: Argentina: Lavagna Decries GoA Crisis Initiatives, Projects
Stagflation in 2009, Warns on Money Laundering

Ref:(A) Buenos Aires 1682
(B) Buenos Aires 1667
(C) Buenos Aires 1653

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Summary

¶1. (SBU) Former Economy Minister and Presidential Candidate Roberto Lavagna in a December 11 meeting with Ambassador projected stagflation in 2009, with zero percent GDP growth but with real inflation not falling below 20%, and warned about money laundering concerns related to GoA legislation; see para 3 action request. Lavagna said the GoA will command sufficient resources to remain current on debt principal and interest payments coming due in 2009. Lavagna doubted there would be an economic crisis in 2010 so long as the GoA sustains "minimally rational" policies and can sustain adequate foreign currency reserves. The international financial crisis' impact on Argentina has been limited relative to its impact on globalized Brazil given this country's isolation from international capital markets. Nevertheless, Argentina would have been in better shape to confront this crisis had the Kirchner administration not abandoned the anti-cyclic fund Lavagna had established in October 2005. Accumulating rainy day savings would have done much to sustain business confidence and stem capital flight in current uncertain times, but Lavagna called such prudence incompatible with the Kirchner administration's vast appetite for public spending.

¶2. (SBU) Lavagna called unworkable the recently announced GoA package of public works and consumer/industrial credit stimulus measures. As an alternative, he recently proposed a six-month reduction in Argentina's 21% VAT tax to broadly stimulate consumption and to address the regressive nature of the VAT on poorer consumers suffering from the decline in economic activity. Lavagna called the nationalization of the private pension funds (AFJPs) another example of the GoA's penchant to interfere with private sector players, including the GoA's recent tilting against U.S. energy major AES's Edelap electricity distribution affiliate and its just-announced intent to buy out Lockheed Martin's Cordoba aviation facility.

¶3. (SBU) Lavagna called the GoA's capital repatriation proposal "misguided." Over US$28 billion in capital flight over the past three years left because of the Kirchner administration's failure to create and sustain confidence in its economic management and because of the GoA's regulatory and tax policy gamesmanship. Lavagna feared that the only flight capital that would return to Argentina given the program's limited safeguards on investigating fund sources under

this minimally supervised program would be "dark" money. A group of prominent economists, politicians, and ex-GoA officials had joined his blog appeal against this GoA proposal. Comment: Post would very much appreciate immediate guidance/input from Washington on GoA-supported legislation to allow the penalt-free return of capital to Argentina that is likely to pass this week. Many commentators have highlighted the chances of much dirty money flowing in via this legislation. End Comment.

¶4. (SBU) Finally, Lavagna argued that the opposition will have a hard time uniting in advance of October 2009's mid-term elections given the spoiler role played by Elisa Carrio. "Carrio and Nestor Kirchner are useful to each other," Lavagna argued, since both are trying to destroy the center to ensure that no "rational" opposition can coalesce.

End Summary

Stagflation in 2009 But No Funding Crisis

¶5. (SBU) Ambassador met December 11 with former Economy Minister and 2007 opposition presidential candidate Roberto Lavagna to review Lavagna's views on Argentina's current economic performance, the impact the international financial crisis has had here, upcoming mid-term 2009 elections, the private pension fund nationalization, the GoA's stimulus package and Lavagna's alternative VAT tax reduction proposal, and Lavagna's vocal opposition to the GoA's capital repatriation proposal.

¶6. (SBU) With the U.S. economy's recession now officially dated to

December 2007, Lavagna said that Argentina's economic downturn will, in retrospect, be seen to have begun in the second trimester of ¶2006. He projected stagflation in 2009, with zero percent GDP growth but with real inflation hovering around 20%. Despite the significant drop in federal tax revenues that such decline in growth implies, the GoA will, he said, command sufficient resources to remain current on debt principal and interest payments coming due in ¶2009. This is due to the cushion provided by the nationalization of private pension funds (which allows both the automatic rollover of GoA government debt they held along with roughly US$ 4 billion per year in contributor inflows) as well as to new budget law provisions that allow the GoA access to an increased share of central bank (BCRA) reserves and to (state-owned) Banco de la Nacion (BNA) resources (Ref A). (Comment: Economists estimate that having access to AFJP funds will reduce GoA annual financing needs by US$ 4-5 billion, with potential new lending from the BCRA and BNA topping US$ 6 billion.)

¶7. (SBU) Lavagna doubted there would be an economic crisis in 2010 so long as the GoA sustains "minimally rationale" policies. Maintaining adequate foreign currency reserves will be a key medium term challenge for the GoA, since ongoing capital flight ("to Uruguay, safety deposit boxes and to mattresses") is draining central bank coffers and the 2007 and projected 2008 US$12 billion trade surplus will "evaporate" in 2009 with the decline in agricultural commodity prices.

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VAT Reduction Alternative to GoA Stimulus Package

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¶8. (U) Ambassador noted recent media coverage on Lavagna's doubts about the efficacy of the recently announced (Ref B) GoA package of public works and consumer/industrial credit stimulus measures. On December 7, in an interview with Argentina's largest circulation daily Clarin, Lavagna called these stimulus measures unworkable. As an alternative he had recommended a six-month, two percentage point reduction in Argentina's 21% VAT, with an additional one percentage point VAT reduction for primary consumption basket products, targeted at poor consumers. In that interview he called his proposal the best way to broadly stimulate consumption and to address the regressive nature of the VAT consumption tax on poorer consumers impacted by the decline in economic activity.

¶9. (SBU) Lavagna noted that, as Economy Minister in the aftermath of

the 2001/2 economic crisis, he had implemented a similar two percentage point reduction in the VAT in 2002. He said it had had an immediate and significant psychological impact on the populace, booting overall consumption and reducing headline prices on a number of consumer goods. The GoA's automotive and consumer durable stimulus packages won't be effective, Lavagna said; their implementation rollout has been slow and painful with squabbling between Kirchner administration officials (principally between new Production Minister Debra Giorgi and Internal Commerce Secretary Guillermo Moreno) over their structure already receiving high-profile media attention. Lavagna offered little hope his alternative proposal would be adopted, saying "I don't talk to Nester Kirchner any more, though I know he looks at my suggestions on my website."

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Lack of Counter-cyclic Funds Exacerbate Crisis
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¶10. (SBU) The crisis is having a major impact on Brazil's globalized economy, Lavagna said, but less of one on Argentina, which is relatively isolated from international capital markets. The Kirchner administration's worst mistake, he said, was in abandoning the anti-cyclic fund Lavagna had established in October 2005 shortly before his departure from government, with a goal of accumulating some US$15 billion. Chile established a similar fund years ago and has accumulated US$23 billion to date. The idea of accumulating rainy day savings, which would have done much to sustain business confidence and stem capital flight in these uncertain economic times, were simply incompatible with the Kirchner administration's insatiable appetite for public spending, he said. Such public spending had increased 50% in both 2006 and 2007 and had increased roughly 41% to date in 2008. (Lavagna cautioned that changes in GoA budget calculation methodology were understating the rate of expansion of public spending and that the increase in 2008 public spending to date has in fact been closer to 50%.) Lavagna said that he had also proposed a reduction in taxes for employment-generating small business in October 2005, but both this and his anti-cyclic fund proposals were abandoned following the subsequent December 2005 cabinet shuffle, where Lavagna was relieved of his position.

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AFJP Nationalization: Standard GoA Modus Operandi
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¶11. (SBU) Lavagna called the AFJP nationalization just one more example of the GoA's penchant to interfere with private sector players. He called the GoA's recent tilting against U.S. energy major AES' Edelap electricity distribution affiliate (Ref C) and its just announced intent to buy out Lockheed Martin's Cordoba aviation facility are only the latest in a string of GoA meddling that included actions to expropriate Spanish-owned flag air carrier Aerolineas Argentina and to ensure friendly local hands hold an equity stake in energy major Repsol/YPF.

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Blog on "Misguided" Capital Repatriation Proposal
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¶12. (SBU) Lavagna said he had been focusing his attention and blog-writing over the past few weeks on the GoA's "misguided" capital repatriation proposal (Ref A). US$28-odd billion in capital flight over the past three years ($3 billion in 2006, $8.8 billion in 2007 and $16.5 billion to date in 2008) had left because of the Kirchner administration's failure to create and sustain confidence in its economic management, he said, and more specifically, because of the GoA's serial regulatory and tax policy gamesmanship. Lavagna feared that the only flight capital that would return to Argentina under this minimally supervised program would be "dark" money. "Good businesses want confidence, not easy repatriation fixes," he added, noting that Mexican President Calderon (presumably referring to his own experience with narco-traffickers) had earlier warned about allowing such funds easy entry. "Once you let them in, you'll never get them out," he quoted Calderon as saying.

¶13. (SBU) Lavagna said that a number of prominent economists, politicians and ex-GoA officials had joined his blog appeal against

the GoA proposal to facilitate capital repatriation with only limited safeguards on investigating fund sources. These include former tax administration director Alberto Abad, former Economy Minister Martin Lousteau, opposition PRO politicians Federico Pinedo and Esteban Bullrich, former Cordoba governor Jose Manuel de la Sota, former Menem Vice Economy Minister Juan Jose Llach and former Buenos Aires province governor Felipe Sola. Lavagna said that these officials had agreed that, if/when they returned to public office, they would take steps to thoroughly investigate the sources of funds entering Argentina under this repatriation proposal. Comment: Many commentators have, in the press, made similar warnings about dirty money flowing in, but the measure is set to be voted on by the Senate this week. Post would appreciate Washington guidance on this issue. End Comment.

Weak Opposition in 2009 Mid-Term Elections

¶14. (SBU) The opposition will have a hard time uniting against the GoA in advance of October 2009 mid-term elections given the spoiler role that opposition figure (and his fellow rival in last year's presidential campaign) Elisa Carrio is playing, Lavagna said. He noted that she had declined to join the large group of opposition figures who supported Lavagna's anti-capital repatriation blog. "Carrio and Nestor Kirchner are useful to each other," Lavagna argued, since both are trying to destroy the center to ensure that no "rational" opposition can coalesce.

¶15. (SBU) In the Province of Buenos Aires, Lavagna said that his own votes in the 2007 presidential elections had been limited by Nestor Kirchner's decision not to allow a single ballot law (on the model of one in Cordoba province) to move forward. (Lavagna lost the 2007 presidential elections with 16.9% of the popular vote, vs. 23.0% for Elisa Carrio and 45.3% for Cristina Fernandez de Kirchner). Kirchner operatives paid people ARP 100 (roughly US$ 30) to remove opposition party ballots from voting booths, Lavagna said, noting "we just weren't ready for these tactics."

Comment

¶16. (SBU) Following his presidential election defeat in December 2007, Lavagna has maintained a low profile, engaging on specific policy issues and defending his 2002-5 tenure as Economy Minister under President Duhalde and Nestor Kirchner. Predictably, Lavagna has been largely silent on two still-controversial economic

initiatives he championed during this tenure: the increased reliance on new taxes that primarily accrue to the federal government that substantially augmented the president's power and control over provincial governors, and sustaining an undervalued currency that has contributed substantially to domestic inflation. Lavagna had been written off by some analysts as hopelessly politically naive following a highly publicized February 2008 post-election reconciliation meeting with Nestor Kirchner during which Lavagna endorsed Kirchner's efforts to lead and reorganize the Peronist party. Lavagna's subsequent public interventions have been limited to critiques of GoA economic initiatives, where his experience and reputation for seriousness have sustained his image as a voice of sober reason.

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